

# Financial Institutions

## E-ALERT

October 14, 2008

### Treasury Announces Capital Purchase Program for Financial Institutions

Today, the Department of Treasury, in coordination with the Federal Reserve Board and Federal Deposit Insurance Corporation, announced a comprehensive Capital Purchase Program whereby Treasury will purchase up to \$250 billion of senior preferred shares in qualifying U.S. financial institutions. The funds for this program will be drawn from the \$700 billion authorized by Congress in the emergency economic recovery legislation enacted in early October.

Several financial institutions have already agreed to participate in the program: Citigroup, J.P. Morgan Chase, Bank of America (including Merrill Lynch), Wells Fargo, Goldman Sachs, Morgan Stanley, Bank of New York Mellon, and State Street. Institutions interested in participating in the program should contact their primary federal regulator for details.

The following is a summary of the Capital Purchase Program's key elements:

- Qualifying financial institutions ("QFIs") are (1) U.S. banks or savings associations; (2) U.S. bank holding companies and savings and loan holding companies that only engage in activities permissible for financial holding companies; and (3) any U.S. bank holding companies and savings and loan holding companies whose U.S. depository institution subsidiaries are the subject of an application under section 4(c)(8) of the Bank Holding Company Act. The term QFI does not include a bank, savings association, bank holding company, or savings and loan holding company that is controlled by a foreign bank or company. The Department of Treasury will determine eligibility for QFIs after consultation with the appropriate Federal banking agency.
- Each QFI may issue an amount of senior preferred stock equal to not less than 1 percent of its risk-weighted assets and not more than the lesser of (i) \$25 billion and (ii) 3 percent of its risk-weighted assets. The senior preferred shares will be perpetual in nature and will qualify as Tier 1 capital for regulatory capital purposes.
- The senior preferred stock will have a liquidation preference of \$1,000 per share, although Treasury may agree to purchase senior preferred stock with a higher liquidation preference depending on the QFI's available authorized preferred shares. The senior preferred shares will be senior to common stock and pari passu with existing preferred shares, other than preferred shares that rank junior to any existing preferred shares.

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- The senior preferred stock will pay cumulative dividends at 5 percent per annum for the first five years and at 9 percent thereafter. For senior preferred shares issued by banks that are not subsidiaries of holding companies, the dividends are paid at the same rates, only on a non-cumulative basis. Dividends will be payable quarterly in arrears on February 15, May 15, August 15, and November 15 of each year. As long as any senior preferred shares are outstanding, no dividends may be declared or paid on junior preferred, preferred shares ranking pari passu, or common shares, nor may the QFI repurchase or redeem any of such shares, unless all accrued and unpaid dividends for the past dividend periods on the senior preferred shares are fully paid. In addition, Treasury must consent to any increase in common dividends occurring during the first three years of the investment (unless Treasury has transferred all of its senior preferred shares to third parties).
- Senior preferred shares may not be redeemed for a period of three years from the date of the investment, subject to limited exceptions. After the third year, the shares may be redeemed in whole or in part at any time at the option of the QFI. Redemptions will be at 100 percent of the issue price plus any accrued and unpaid dividends.
- The senior preferred shares will be non-voting, other than class voting rights on (1) any authorization or issuance of shares ranking senior to the senior preferred, (2) any amendment to the rights of senior preferred, or (3) any merger, exchange or similar transaction that would adversely affect the rights of the senior preferred. If dividends on the senior preferred are not paid in full for six dividend periods, whether or not consecutive, the senior preferred will have the right to elect 2 directors. This right will cease when full dividends have been paid for four consecutive dividend periods.
- Treasury may transfer senior preferred shares that it holds to a third party at any time.
- As long as Treasury holds senior preferred shares, the QFI must agree to certain limitations on executive compensation, including (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the corporation, (2) required clawback of any bonus or incentive compensation based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate, (3) a prohibition on golden parachute payments to senior executives, and (4) agreement not to deduct for tax purposes compensation in excess of \$500,000 for each senior executive.
- In conjunction with the purchase of senior preferred shares, Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15 percent of the senior preferred investment. The warrants' exercise price will be the market price of the participating institution's common stock at the time of issuance, calculated on a 20-trading day trailing average.
- QFIs will have until November 14, 2008 to elect to participate in the Capital Purchase Program. Treasury will make the final determination of eligibility and allocations for individual QFIs after consultation with the appropriate federal banking agency.

Attorneys in Covington's Financial Institutions Group have advised many clients on recent financial services and banking developments. The Financial Institutions Group's expertise derives from advising clients on the impact of such developments over the course of the past three decades. Please do not hesitate to contact any member of our Financial Institutions Group, including the undersigned, should you have any questions.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our financial institutions practice group:

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